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ENHANCING U.S. NATIONAL SECURITY: THE CASE FOR HEMISPHERIC FREE TRADE

BY

RAFAEL L. MARIN
U. S. Department of State

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On June 27, 1990, President George Bush announced the "Enterprise for the Americas Initiative" (EAI). The centerpiece of that Initiative is a proposal for free trade throughout the Americas. The proposal represents a significant departure in U.S. policy toward the rest of the hemisphere by stressing mutually beneficial trade, rather than aid, as the basis for economic relations, development, and growth. The President's proposal has been heralded by most of the hemisphere's leaders but is opposed by some groups, both in the United States and abroad. The study reviews the genesis of the proposal -- the dramatic pro-democracy and pro-market reforms of the past few years -- and examines the theoretical basis for hemispheric free trade within the context of global U.S. trade policy. It concludes that hemispheric free trade, if pursued in consonance with our global trade objectives, would enhance U.S. and hemispheric prosperity and security. It concludes further that decisive U.S. leadership is necessary to bring the vision of free trade in all the Americas to fruition.

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ENHANCING U.S. NATIONAL SECURITY: THE CASE FOR HEMISPHERIC FREE TRADE

AN INDIVIDUAL STUDY PROJECT

by

Rafael L. Marin
U.S. Department of State

Dr. Leif Rosenberger
Project Adviser

U.S. Army War College
Carlisle Barracks, Pennsylvania 17013

ABSTRACT

AUTHOR: Rafael L. Marin, Department of State

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On June 27, 1990, President George Bush announced the "Enterprise for the Americas Initiative" (EAI). The centerpiece of that Initiative is a proposal for free trade throughout the Americas. The proposal represents a significant departure in U.S. policy toward the rest of the hemisphere by stressing mutually beneficial trade, rather than aid, as the basis for economic relations, development, and growth. The President's proposal has been heralded by most of the hemisphere's leaders, but is opposed by some groups, both in the United States and abroad. The study reviews the genesis of the proposal -- the dramatic pro-democracy and pro-market reforms of the past few years -- and examines the theoretical basis for hemispheric free trade within the context of global U.S. trade policy. It concludes that hemispheric free trade, if pursued in consonance with our global trade objectives, would enhance U.S. and hemispheric prosperity and security. It concludes further that decisive U.S. leadership is necessary to bring the vision of free trade in all the Americas to fruition.

PREFACE

The appeal of the United States' humanocentric values and its economic strength allowed it to shape much of the post-World War II international order. Institutions created then at U.S. behest, and which still guide the world's affairs today -- the United Nations, the World Bank, the International Monetary Fund, the General Agreement on Tariffs and Trade, the Organization of American States, and others -- secured our national interests while advancing global welfare.

In 1992, we are at another historic crossroad. As in 1945, we are the world's undisputed military power, and our national values of democracy, respect for human rights, and the freedom of the market are again the beacons guiding nations to a brighter future. But, unlike the early post-World War II era, our relative economic power today is much diminished, our ability to shape the post-Cold War order constrained.

Our still-formidable power nonetheless imposes upon us a special burden of world leadership. Nowhere is that leadership in greater demand today than in the Americas, where in the last half-dozen years generations of autocratic, statist rule have yielded to

freely-elected governments in practically every nation of the hemisphere. If the hemisphere remains democratic, prosperous, and free, our own security will be enhanced. Timely and effective U.S. leadership could spell the difference between the survival of these newly-implanted democratic systems, or a return to an earlier era.

Conscious of the historic moment, on June 27, 1990 President Bush launched the Enterprise for the Americas Initiative (EAI). The EAI offers a more mature foundation for hemispheric relations: free trade.

Hemispheric free trade is a visionary idea that, while not entirely new,[1] has never before been formally proposed by a U.S. administration. The hemisphere's new leaders have endorsed it enthusiastically. But, here at home and elsewhere, there are doubters.

Is hemispheric free trade in our interest? Would it enhance our national security, or diminish it? What does it offer our hemispheric partners? What are its costs, if any, to us and our trading partners? Having authored the proposal, have we the national resolve to see it through in the face of political opposition?

This paper examines these issues. In Part I we review the theoretical case for free trade. Part II considers briefly the

hemisphere's astounding transformation in the closing decade of this twentieth century, and traces our economic and trade and relations with the hemisphere. Part III takes a closer look at the President's free trade proposal, examining the pros and cons. In Part IV, we present our conclusions and some recommendations for action.

The key conclusion: the United States should pursue a pan-American free trade agreement as a high-priority national objective. The moment is ripe.

PART I - THE CASE FOR FREE TRADE

FREE TRADE: WHO WINS?

According to the classical theory of comparative advantage,[2] under perfect competition countries with different resource endowments can each gain from trade. Moreover, economic efficiency is maximized if trade is unimpeded. But perfect competition may never obtain. Does this invalidate the case for free trade?

Recent theoretical work suggests gains from trade are possible even in the absence of perfect competition. Furthermore, the weight of the evidence continues to favor less, rather than more, government intervention in trade.[3] Indeed, government intervention in trade is found generally to be either harmful, or a poor

substitute for alternative policies that could better address specific economic distortions.[4]

In moving toward free (or freer) trade, however, some groups are apt to feel distress in the short run unless they get help to adjust to their new competitive environment. Nonetheless, the theoretical and empirical evidence suggests that the benefits of free trade generally outweigh those adjustment costs sufficiently, so that "winners" can compensate "losers" and still have enough gains left over to spread among all consumers.[5] (We should note that producers and workers are consumers, too, and as such also benefit from free trade.)

This, then, is the theoretical case for free trade.

FREE TRADE: FOUNDATION OF U.S. TRADE POLICY

The United States has long championed free trade, and has sought to base its trade policy on free trade's intellectual underpinnings.

Following World War II, with the objective of spurring world trade and accelerating the reconstruction of war-torn Europe and Japan, the United States moved decisively to help found the General Agreement on Tariffs and Trade (GATT). While not a free trade regime, the GATT did create a framework for reducing trade barriers. Since its inception in 1947, the GATT has successfully

negotiated seven rounds of successive tariff reductions and other trade-liberalizing measures. Not coincidentally, world trade mushroomed.

Protectionism has nonetheless always been a strong counter-current in the United States, and is far from dead today. Indeed, the last two decades have seen a growing trend toward protectionism.[6]

Trade intervention can, under certain circumstances, produce economic rents (monopoly profits) for protected home producers.[7] Not surprisingly, as the GATT has slashed tariffs and quotas, governments -- including our own -- have found other means to thwart imports. Today, non-tariff barriers abound, including import-discouraging government regulations (especially in the areas of environment and health); industrial standards skewed in favor of home producers; biased procurement practices (both public and private); "voluntary" export restraints (VERs); "orderly marketing arrangements" (OMAs); etc. Moreover, as the mix of world trade has shifted to ever more agricultural products and services, a growing share of world trade is subjected to government intervention. GATT rules, unfortunately, do not yet cover those services or agricultural products effectively.

Given this erosion in international trade discipline, the GATT has understandably come under criticism. Convinced that a major

overhaul of the GATT was necessary for world trade to continue expanding, the United States in the early 1980s began pressing for a new round of GATT liberalization.[8] Those efforts paid off in 1986, when the GATT contracting parties agreed to undertake the most far-reaching reform of the GATT since that institution's inception. The GATT "Uruguay Round" (so called in honor of the country that hosted the fateful meeting) was launched.

The Uruguay Round was to have concluded on December 31, 1990, but the United States (and like-minded countries) on the one hand and the European Community (EC) on the other remained too far apart on key issues. The main stumbling block has been agriculture, with the United States insisting on major cuts in barriers to agricultural trade, and the EC adamant in protecting its farmers.[9] The deadline for the Round passed without final agreement.

Rather than risk the possibly devastating surge of protectionism that failure of the Uruguay Round might usher, the GATT contracting parties agreed to extend the Round until mid-1993.[10] In keeping with that decision, Congress extended the President's special "fast-track" negotiating authority until June 1993.[11] A successful GATT round that embraces agriculture and services, and encompasses investment and intellectual property, is the cornerstone of U.S. international trade policy today.[12]

But how does President Bush's regional free trade proposal

square with our global trade objectives? We turn to this question next.

FREE TRADE AREAS: PROS AND CONS

A free trade area (FTA) can be said to expand economic well-being if it increases aggregate output (i.e., raises national income). In the short run, however, moving to free trade can affect some individuals and firms adversely. For example, producers who had formerly enjoyed protection from import competition might have to abandon inefficient lines of production in the face of new competition. Even in this case, however, free trade is generally preferred, since total gains exceed total costs.

But quantifying a proposed FTA's likely effects on national income is a difficult proposition, if not a practical impossibility.[13] To get around this problem, Professor Jacob Viner suggested an analytical framework in 1950 that compares an FTA's *trade creation* and its *trade diversion* effects.[14] If an FTA creates more trade than it diverts, it is deemed preferable to its antecedent.

As Viner showed, even economically justified FTAs can sometimes divert trade from lower-cost producers (outside the FTA) to higher-cost ones (inside the FTA), resulting in some loss of economic efficiency.[15] This does not invalidate the pro-free trade argument, however, since the gains from trade creation will

normally still exceed the trade diversion losses, as discussed above.

Viner's analytical framework, however, provides an essentially static, short-term view, and focuses mainly on costs. Subsequent writers have shown that, even when there is trade diversion, the dynamic effects of an FTA (for example, on investment, and other efficiencies) can more than compensate for the trade diversion costs.[16]

MAXIMIZING THE BENEFITS OF FTAs

Fortunately, an FTA's trade diversion costs can be mitigated, and its trade creation effects enhanced, under the following conditions:[17]

- the tariffs of countries outside the FTA are high;
- pre-FTA tariffs of the FTA members were also high;
- after establishment, the FTA members' tariffs against non-members are low;
- the FTA members were already major trading partners and strong competitors before the FTA's creation;
- the members are close geographically (this minimizes shipping differentials);

- o the members are at roughly comparable levels of development, and
- o the FTA is comprehensive (i.e., covers essentially all trade among the members).

The implications of the foregoing for U.S. policy include the following:

- o We should not participate in any FTA that raises existing barriers against the rest of the world.

Comment: The likelihood that any of our western hemisphere trading partners would seek increased protection within an FTA is small. A majority of the countries in the hemisphere are in fact already moving in the opposite direction of their own accord. (Part III provides additional discussion of this development.)

- o We should anticipate that our Western Hemisphere trading partners' differing levels of development will produce some political strains.

Comment: Some Latin or Caribbean countries may lack sufficient capital to upgrade their industrial plant to compete effectively with their more powerful North American counterparts. The remedies are clear: phase in the dismantling of protection by the weaker member states to allow them sufficient time to adjust, and provide

them technical assistance (and possibly some direct aid) until they are strong enough to compete effectively.

- A hemispheric FTA must include highly-protected U.S. sectors, such as textiles and apparel, sugar, etc.

Comment: To exclude these sectors (as does the Caribbean Basin Initiative -- see below) would diminish an FTA's attraction for many of the developing countries in the hemisphere, particularly those which face the largest adjustment burdens.

This brings us to the next question: what benefits would our trading partners derive from hemispheric free trade? Before addressing it, however, let us take a brief look at recent events in the hemisphere.

PART II - THE AMERICAS IN TRANSITION

The Western Hemisphere has changed more profoundly in the last decade than at any time since the nineteenth century wars of independence. When *glasnost* and *perestroika* were just beginning to reshape the Soviet empire at the end of the 1980s, the peoples of this hemisphere were already well into their own political and economic revolution, through free and fair elections.

By 1990, with the notable exception of Cuba, in every American

republic where authoritarian or military regimes had once held sway, democratic, pro-market governments had been elected to take their place.[18] In Central America, internecine wars began to yield to political accommodation. Nations that had pursued industrialization by shielding domestic producers from external competition jettisoned this once-popular "import substitution" model. That economic development model produced positive results while commodity export prices were buoyant and external loans plentiful, although at the cost of growing economic rigidity and declining international competitiveness. When the conditions that made that model viable soured in the early 1980s (on the heels of the second oil shock and ensuing world recession), the economic house of cards built on import substitution collapsed.

Epochal change has not spared industrial North America. In 1988, the United Sates and Canada finally gave substance to an age-old dream: bilateral free trade. The 1988 U.S.-Canada Free Trade Agreement (CAFTA) eliminates virtually all bilateral trade barriers, and creates new rules on bilateral investment, intellectual property rights, and trade in services that are models for the world.[19] On our southern flank, Mexico has cast aside generations of suspicion of the "Colossus of the North" and proposed that the United States and Mexico, too, trade freely. Today the three -- the United States, Canada and Mexico -- are engaged in intensive negotiations to implant free trade "from the Arctic Circle to the Yucatan."[20]

Many forces helped propel these monumental changes. The international debt crisis unmasked the real costs of the import substitution strategy, while laying bare the political bankruptcy of autocratic and militarist rule; "glasnost" and "perestroika" signalled the ascendancy of political and economic freedom around the world; the end of the Cold War, and consequent loss of communist patronage, caused many of the hemisphere's insurgencies to revise their calculus of belligerency.

These changes in the rest of the hemisphere affect our own national security and interests profoundly. And, as regional links intensify, our stake in the welfare of our sister American republics grows.

Before turning to the free trade connection, let us briefly review recent U.S. economic relations with the rest of the Americas.

U.S.-HEMISPHERIC RELATIONS

The United States has always projected an important presence in the hemisphere, even in those periods of our history when we have been turned mostly inward. That presence has many dimensions, but we will confine our review to economic aspects.

Tables I and II reveal the importance of the U.S. trade relations with the hemisphere. U.S.-Canada bilateral trade dwarfs

Table I. SHARES OF INTRA-TRADE IN NORTH AND SOUTH AMERICAN COUNTRIES

TOTAL IMPORTS - 1988

Exporter	Total Imports ($ millions)	Share of total imports from N. and S. America (%) Total	From U.S.
Argentina	5,322	50.2	16.7
Bolivia	766	68.1	21.0
Brazil *	16,054	36.1	20.1
Canada *	86,810	71.1	68.0
Chile	4,731	52.6	21.2
Colombia	5,005	60.9	36.2
Ecuador	1,714	54.0	33.1
Mexico *	9,428	72.5	65.9
Parguay	574	54.9	10.0
Peru *	2,365	60.3	25.9
Uruguay	1,177	59.7	7.9
United States	458,682	29.2 ***	----
Venezuela **	14,690	56.8	42.0

* - 1987
** - 1986
*** - of which 17.6 percentage points from Canada, and 11.6 points from the rest of the hemisphere.

Source: Erzan, Refik and Alexander Yeats, "Free Trade Agreements with the United States: What's In It For Latin America?" The World Bank, Washington, D.C. (January 1992).

Table II. SHARES OF INTRA-TRADE IN NORTH AND SOUTH AMERICAN COUNTRIES

TOTAL EXPORTS - 1988

Exporter	Total Exports ($ millions)	Share of total exports to N. and S. America (%) Total	To U.S.
Argentina	9,134	34.7	16.9
Bolivia	570	74.6	16.9
Brazil *	26,229	41.8	26.7
Canada *	92,886	78.0	75.8
Chile	6,794	32.6	18.3
Colombia	5,026	56.6	39.3
Ecuador	2,192	67.3	45.9
Mexico *	19,354	73.6	64.6
Parguay	510	45.9	3.8
Peru *	2,152	49.5	29.9
Uruguay	1,443	39.4	11.2
United States	303,380	35.1	----
Venezuela **	8,613	65.6	52.9

* - 1987
** - 1986

Source: Erzan, Refik and Alexander Yeats, "Free Trade Agreements with the United States: What's In It For Latin America?" The World Bank, Washington, D.C. (January 1992).

that between any other two countries in the world. (At some $178 billion in 1990, it was close to our total trade of $195 billion with the whole of the European Community that year.)[21] Our third largest trading partner, after Canada and Japan, is Mexico.[22]

Though less intense, our economic relations with our other hemispheric partners are of considerable importance. We are the most important export market for most of those countries (Table II). Moreover, the volume of U.S. investment in the rest of the Americas exceeds that from all other sources combined.[23]

Our own well-being is tied to Latin America's, and vice versa. For example, over half of Latin American imports (some 14 percent of our exports) are sourced in the United States.[24]

MORE TRADE, NOT AID

As Table III indicates, U.S. economic, financial, and military assistance have also been major elements in U.S.-Latin American post-War relations. This has been especially true in the last decade, and particularly in Central America and the Caribbean.

In recent years, however, the United States has been placing increasingly greater reliance on trade (and private investment) as the principal means of supporting democratic change and economic progress in the region. This trend began in earnest in 1984, with the Kissinger Commission[25] recommendations for one-way U.S. trade

concessions to the countries of the Caribbean Basin, many of which were then mired in civil strife, recession, or both.

Table III. U.S. ECONOMIC AND OTHER ASSISTANCE TO LATIN AMERICA AND THE CARIBBEAN

($ millions)

Program	1989 (1)	1990 (1)	1991 (2)	1992 (3)
Development Assistance	417.0	390.5	357.1	406.2
Balance of payments support (ESF)	550.4	1,093.0	703.7	713.9
Food Aid (PL-480)	385.1	284.3	301.8	300.2
Peace Corps	28.5	24.4	25.7	28.0
Military Assistance	161.3	231.8	222.4	279.2
Narcotics Control	55.4	72.0	86.6	99.9
U.S. Contributions to multilateral funds (4)	20.4	52.0	67.4	167.3
Total (5)	1642.6	2173.9	1764.7	2,304.3

Notes:
1) Actual
2) Estimated
3) Requested
4) Includes World Bank, Inter-Amercian Development Bank, Organization of American States
5) Includes other U.S. loans (e.g., Eximbank; Trade and Development Program; Commodity Credit Corporation; Overseas Private Investment Corp.

Source: U.S. Agency for International Development. Latin America and the Caribbean: Selected Economic and Social Data, Washington D.C., (July 1991).

The accomplishments of the resulting Caribbean Basin Initiative (CBI) are instructive for U.S. policy today. Those CBI countries that have availed themselves of the opportunities the CBI program offers[26] have made great strides in diversifying their economies and exports. They have reduced their dependence on the handful of farm crops they traditionally exported (e.g., coffee, sugar, bananas), while making significant gains in industry, especially agro-industry and textiles. We shall revisit this theme in Part III.

Inspired by the CBI's success, the Bush Administration proposed similar concessions for the Andean nations in 1991. This "Andean Initiative" is intended to help those countries combat drug production and trafficking by spurring economic development. Finally, the U.S. Generalized System of Preferences (GSP) accords most developing countries, including all those in this hemisphere (except Cuba), preferential access to the U.S. market for many of their products.

None of these trade concessions, however, is "free trade" as contemplated in the EAI. The CBI, GSP, and Andean Initiative are all unilateral U.S. concessions, and hence can theoretically be rescinded by the U.S. government. We therefore now turn to examine the EAI free trade proposal.

PART III - THE EAI AND FREE TRADE

The EAI in fact contains related proposals in four areas: trade, investment, debt, and the environment. (Appendix A contains a summary of the EAI's main provisions.) But it is the prospect of free trade that makes this a visionary proposal, and which has inspired the region's leaders to intensify their economic reform efforts.

President Bush's free trade offer promises to overhaul hemispheric relations by giving our Western Hemisphere trading partners *guaranteed* duty-free access to the U.S. market. The United States, in turn, would receive like access to their markets. This more mature relationship would help consolidate our shared respect for democracy, the rule of law, and the principles of the market.

"Free trade fever" is now sweeping the hemisphere. Sub-regional groups of countries are pursuing complementary local free trade agendas, both on their own merits, and as a stepping-stone toward hemispheric free trade. The hemisphere's leaders apparently believe a pan-American free trade area is an idea whose time has come -- and they are counting on the United States to help make it happen.[27]

WHAT CAN FREE TRADE OFFER OUR LATIN/CARIBBEAN PARTNERS?

So enthusiastic has been the pro-free trade response throughout the hemisphere that one might conclude the proposal contains no drawbacks for our trading partners.[28] What *do* they stand to gain?

The challenges that free trade poses for our trading partners are much the same as those we might face. Indeed, with more highly protected (and consequently less efficient) industry than our own, many of our partners might even have reason for pause.

Some observers suggest free trade promises most of our Latin American trading partners relatively modest prospects of increasing their exports significantly. For example, recent estimates by World Bank economists suggest the eleven largest Latin economies might raise their total exports by some $2.9 billion (on their present export base of some $35 billion), or an average gain of only about eight percent.[29] Results would be particularly modest for those small countries the bulk of whose exports already enter the United States without significant restrictions (as, for example, most Caribbean countries).[30] Mexico could be a big gainer in absolute terms, capturing somewhat over half of the export increment, but would still fare little better in relative terms than the average for all of Latin America. Potential gains for the remaining countries would fall somewhere in between.[31]

Are the prospects of a comprehensive hemispheric free trade agreement in fact so modest? If so, why have our Latin American trading partners embraced the proposal so enthusiastically?

Part of the answer is that they are driven by the same motivations that propelled Canada to seek free trade with us:[32] (a) gain assurance of continued access to the U.S. market in the face of rising U.S. protectionism, and (b) gain protection from unilateral application of U.S. countervailing and anti-dumping laws. Now that negotiations for free trade with Mexico are underway in earnest, an additional aim of many countries is to prevent erosion of their position in the North American market.

Part of the reason that existing projections of the benefits of hemispheric free trade are so modest is that the trade creation/trade diversion model provides only a static view; it fails to capture an FTA's potential effects on investment, externalities, and other dynamic effects.[33]

One would indeed expect a pan-American free trade area's greatest punch would spring from those dynamic effects. The experience of the Caribbean Basin countries under the CBI is encouraging in this regard. As Table IV shows, the CBI region has significantly expanded its *non-traditional* exports to the United States since the inception of the CBI program: from less than 18 percent in 1983, to more than half of all exports by 1991. Those

countries have successfully diversified their production, making their economies less vulnerable to the vagaries of international commodity prices.

Table IV. CENTRAL AMERICAN EXPORTS TO THE UNITED STATES

($ millions)

Category	1983	1991	Average Annual Change (%)
TOTAL	1,947.3	3,228.7	6.5
Primary	1,572.9	1,651.9	2.6
Manufactures	286.8	1,495.1	32.0
Non-traditional products *	335.1	1,697.6	22.5

Composition of Exports (% of Total Exports)

Category	1983	1991
Primary	80.7	51.2
Manufactures	19.3	48.8
Non-traditional products *	17.2	52.6

* - Non-traditional products include: manufactures; fruits and vegetables; plants.

Source: U.S. Agency for International Development Database, based on U.S. Department of Commerce data.

No less important are the social and political changes that have accompanied this economic progress:

-- better-paying jobs raise family income sufficiently to enable youngsters to stay in school longer;

-- an expanding middle class, committed to the economic and political reforms, is willing to challenge the political power of the old oligarchies;

-- women have a growing role in the work force.[34]

Political democracy and its economic analog, the market, have found nourishing soil in Central America and the Caribbean on the foundations of one-way free trade. That this also enhances U.S. national security hardly needs elaborating.

Recent Central American experience, and of others such as the European Common Market, suggest hemispheric free trade can offer its constituents other benefits as well. Commitments to free trade constrain FTA members from using trade policy for narrow domestic economic purposes. This places a greater premium on good national macroeconomic policy management. Better macroeconomic policies in turn improve the climate for economic coordination on a broader scale, leading ultimately to greater economic efficiency, and yet higher living standards, for the region as a whole.

OTHER OBJECTIONS TO HEMISPHERIC FREE TRADE

Some critics oppose hemispheric free trade for reasons other than those already mentioned. We now examine their views in turn.

1. The United States Will Lose Jobs

According to this argument, free trade would cause the United States to lose jobs to the lower-wage members in the FTA.

Except for those industries that now enjoy high levels of protection (at considerable cost to consumers, we might add), the wage argument is specious. The average U.S. tariff on imports is now less than five percent (although rates can be considerably higher for some highly protected commodities). As noted earlier, a significant proportion of imports from Canada, the Caribbean, and the Andean countries already enter duty-free. On the other hand, real wages in the United States are a large multiple of wages in any of the other countries of the hemisphere, except Canada. This means that, in relative terms, average U.S. tariff protection today is a mere fraction of what would be needed to offset those countries' wage advantage. Were low wages the main determinant of U.S. investors' decisions, many more manufacturing jobs should have already moved south.

Of course, free trade will increase competitive pressures on highly protected sectors, whether in the United States or elsewhere. This impact may include loss of jobs and the closure of

some plants in particularly inefficient, non-competitive industries. However, while this raises important questions of equity and social policy, it should not be a reason for denying the benefits of free trade to all consumers.

Something the "job loss" critics fail to acknowledge are the costs of protection. These can indeed be substantial, although, because they tend to be widely dispersed, usually escape consumers' notice. A few examples will suffice:

-- In the clothing and textile sector (one of the most highly protected not just in the United States, but in other developed markets as well), the cost of protection to the American consumer in 1987 was estimated at some $11 billion (in the form of higher prices). Meanwhile, U.S. textile producers gained slightly more than $4 billion from that protection -- a net loss of some $7 billion to the U.S. economy.[35]

-- Another study estimated that U.S. consumers lost $5.8 billion in 1984 through U.S.-imposed "voluntary" restraints on Japanese car exports to the United States, while the gain to U.S. auto makers was only $2.6 billion.[36]

A similar story can be told for machine tools, sugar, and other

highly protected industries.

The real "jobs" issue that free trade poses -- for labor as well as for U.S. policy makers -- is how to provide affected workers and firms enough time and sufficient means to adjust to the new, competitive market conditions. Unfortunately, our poor record of managing this process in the past tends to harden opposition to free trade proposals.[37] We will need to do better on trade adjustment.

A final consideration on this theme: the economic adjustments that free trade imposes are qualitatively no different from those we face every day from technological innovation. No one would propose (we hope) that we hold back technology in order to avoid the economic adjustment costs that innovation entails. In the same vein, the need for adjustment should not be an excuse for blocking progress toward free trade and its benefits.

2. Hemispheric Free Trade Undermines Our GATT Objectives.

According to this argument, the quest for hemispheric free trade diverts scarce resources from, and thereby undermines, our more global GATT reform goal. This view contends further that opponents of GATT reform will misrepresent our position in their efforts to stall progress in the GATT.

The argument is not convincing. First, if pursuing GATT and

hemispheric regional talks concurrently taxes our resources, we should augment those resources as necessary, not shortchange our objectives. Second, the U.S. government's position on the role of hemispheric free trade in our overall trade policy is quite clear: achieving a successful Uruguay Round is our top priority, and any regional free trade agreements must be consistent with that objective.[38]

A well-negotiated hemispheric FTA could in fact advance our future GATT goals by paving the way on issues that may now be intractable in the broader GATT framework. Crafting agreements in the GATT (which now has 108 members) can be much more difficult than attempting to do the same in more restricted forums. Since GATT agreements are on the basis of consensus, any member can drag his feet and stymie the negotiations (the so-called "convoy" problem of multilateral negotiations). By contrast, a group of like-minded countries can more easily break new ground. This was the case, for instance, in the 1988 Canada-U.S. free trade negotiations.[39]

Two important caveats are in order: we must not view hemispheric free trade as a substitute for global free trade, but rather as a way station thereto. And we must not be seduced by the managed trade advocates who would use pan-American free trade as a weapon against United Europe and Japan/ASEAN/Asia. To do either would be to start down the slippery slope toward trade wars that

would benefit no one and harm all.

2. Hemispheric Free Trade Will Harm the Environment

Some ecologists have expressed concern that the North American free trade agreement we are now negotiating with Mexico and Canada could lead to environmental harm. They argue that polluting industries could escape U.S. and Canadian controls by relocating to Mexico, where environmental safeguards are less stringent. They apply the same reasoning to a hemispheric FTA.

Pollution is indeed a legitimate concern, as the pending issues of North American transborder pollution amply attest.[39] But the concern that a North American or hemispheric FTA would result in environmental damage is mostly conjecture.

None of the countries involved wants to pollute its own territory. Indeed, the governments of the hemisphere are now virtually unanimous in their resolve to overcome environmental problems within their borders, and are demanding their neighbors do the same. Admittedly, they sometimes fall short on execution, but that has nothing to do with free trade. Environmental protection is today a recurring theme in the sub-regional cooperation agreements that countries in the hemisphere have concluded in the past few years.[40]

Actions by the Salinas administration in Mexico illustrate

this point. In 1991 it ordered the national oil company, Pemex, to close a highly polluting refinery in Mexico City, with the loss of hundreds of millions of dollars in foregone production and hundreds of jobs. Moreover, the Mexican government is interested in preventing new pollution problems: in August 1991, it joined the U.S. government in releasing a joint plan to combat pollution on both sides of our common border and in Mexico City.[41] More recently, President Salinas asked the U.S. administration to halt the planned construction of three hazardous-waste dumps in Texas, near the already heavily polluted border area.[42]

Environmental concerns *should* be a part of any regional free trade negotiations. But they should not be an excuse for scuttling them.

4. Human Rights Concerns

Those who oppose hemispheric free trade on human rights grounds argue that free trade will engender sweatshop conditions in the lower-wage members of the group. This would not only violate internationally-accepted worker rights standards, but would create unfair competition for the United States. Furthermore, say these critics, free trade would reward regimes that have shown little regard for the human rights of their peoples in the past.

These issues, too, deserve careful attention. However, free trade is not the source of the human rights conditions feared. On

the contrary, it can help attenuate them. The real causes of those conditions are the low levels of economic and institutional development, and inadequate worker protection laws (or inadequate enforcement mechanisms) in the countries affected. Ironically, denying those countries the potential benefits of free trade -- higher incomes, more robust economies, and greater individual freedom -- could help perpetuate the very conditions human rights advocates seek to redress.

PART IV - CONCLUSIONS AND RECOMMENDATIONS

Some writers have dubbed the 1980s Latin America's and the Caribbean's "Lost Decade." Yet the end of that traumatic decade found the region marching decisively toward new political, economic, and social arrangements based on open, democratic models. In the economic domain, these countries have clearly shed their predilection for industrial development based on import substitution and government intervention, and chosen the path of export-led growth.

President Bush's proposal for hemispheric free trade is a fitting response to these developments. It would dramatically transform the foundations of U.S. relations with the rest of the hemisphere. It not only offers greater economic well-being for all the citizens of the hemisphere, but reinforces the virtuous circle

of democratic and political reforms blooming throughout the Americas.

Indeed, the President's proposal has inspired the hemisphere's leaders toward reforms more ambitious than those they might have otherwise dared, and has strengthened their commitment to the democratic process. As the recent examples of Haiti (September 1991), Venezuela (February 1992) and Peru (April 1992) painfully demonstrate, the roots of democracy are still quite shallow in much of the hemisphere. An inexpensive (nay, profitable!) way to nourish those roots is to induce greater hemispheric welfare and harmony through free trade. Achieving this, however, will require persistent -- and consistent -- U.S. leadership.

A pan-American free trade agreement will not, however, be problem-free. Some producers and workers, both at home and abroad, could suffer hardship if the provisions for economic adjustment are inadequate. Such provisions will, indeed, be necessary for the U.S. Administration to secure the necessary domestic political support for the free trade agenda.

Fears that hemispheric free trade will bring human rights violations and environmental degradation in its wake are largely unfounded. On the contrary, free trade can reinforce the commitment to human rights and ecologically sound development.

Today, the United States has fewer degrees of freedom to shape world events than we did at the end of World War II. But as the world's most powerful nation still, we retain a special obligation to provide that leadership in this epoch of global change. Our national interests will be protected best if we continue to provide that leadership; they will be harmed if we shrink from the task and let others determine the agenda. In our hemisphere, part of this task is clear: continue to press for free trade with resolve, even as the voices of protectionism grow louder.

For the United States to fail to provide the decisive leadership that implanting hemispheric free trade will require would be to discard a historic opportunity.

ENDNOTES

1. The idea of pan-American free trade was widely discussed in the 1960s. New York's then-governor, Nelson Rockefeller, for example, proposed a much more ambitious arrangement for free movement of goods, capital, and labor "from Point Barrow to Tierra del Fuego." The idea was also actively considered by the U.S. administration, but did not prosper. For additional background, see Dell, Sidney. A Latin American Common Market?, p. 30, ff; Oxford University Press, London (1966).

2. The theory was first suggested by Adam Smith in the 18th century, and amplified by economist David Ricardo in the 19th.

3. Stern, Robert M, and Alan V. Deardorff. "Current Issues in Trade Policy: An Overview," in Stern, Robert M, ed. 1987. U.S. Trade Policies in a Changing World Economy. The MIT Press, Cambridge, Massachusetts. See also McCulloch, Rachel: "United States Trade Policy: Emerging Choices," in Trade, Inflation, and Ethics: Cultural Choices for Americans, Vol. V, pp 25-45, Lexington Books, Lexington, Mass. (1976).

4. For example, a subsidy to producers might be a less distorting policy tool than a tariff to address a competitiveness issue. No intervention at all might be a better policy still. (The merits of intervention would depend on the particular circumstances of the case.)

5. Stern, op. cit.

6. For an overview of recent trends in U.S. trade policy, see the "Background Paper" by Gary Clyde Hufbauer, in The Free Trade Debate, Priority Press Publications, New York (1989).

7. Stern, op. cit, p. 37.

8. According to the "bicycle theory" of trade policy, governments must peddle the trade liberalization "bicycle" continuously, lest it stop and topple.

9. Within the EC, France -- and to a lesser extent Italy and Spain -- have been the most adamant in protecting its farmers. Significant cuts in EC farm production and export subsidies, and in non-tariff barriers to farm imports, are critical to the success of the Uruguay Round.

10. The Uruguay Round negotiations on agriculture are reaching a critical phase as this paper goes to press in mid-April 1992.

11. The Constitution gives Congress the power to regulate commerce, but the executive negotiates international trade agreements (subject to the advice and consent of the Senate). A special process is necessary for handling the exceedingly complex multilateral trade agreements, which otherwise can easily become bogged down in the congressional amendment process. Since 1974, Congress has therefore periodically given the President special "fast track" negotiating authority. This has allowed the President successfully to bring the various GATT trade packages to the Congress for approval, without congressional amendments. (The executive, of course, consults the Congress closely throughout the actual negotiations.) Many of our trading partners would not consider engaging us in serious trade negotiations without the assurance the "fast track" provides against crippling congressional amendments.

12. The White House, Enterprise for the Americas Initiative: A Vision for Economic Growth and Development, p. 5, Washington, D.C. (February 1992).

13. The variables affected include: the incomes of exporters, importers, consumers, producers of import-competing goods; government tax revenues; government spending; investment; etc. In effect, one would have to estimate a general equilibrium macroeconomic model.

14. Viner, Jacob. The Customs Union Issue, Carnegie Endowment for Peace, New York (1950).

15. A hypothetical example will make this clear. Suppose Countries A and B, who each levy tariffs of 20 percent, establish an FTA. Suppose further that country X (not in the FTA) produces widgets at $100, which Country A also produces, but less efficiently -- at $110. Before the FTA, consumers in B would have imported widgets from X (at $120, duty-paid) rather than from A ($132, duty-paid); after the FTA, however, they switch to A, where widgets now cost only $110 (duty free). Nonetheless, the FTA's trade-creating benefits can still outweigh these efficiency "costs." Moreover, if widgets are inputs for Country B producers, these, too, are now more efficient than before.

16. These include efficiency in consumption (i.e., consumers in the FTA have access to less expensive goods than before, even if they are now sourced from economically less efficient producers), and the efficiency in production mentioned in the preceding note.

17. Adapted from Wonnacott, Paul, and Mark Lutz, "Is There a Case for Free Trade Areas?", in Schott, Jeffrey J. (ed), Free Trade Areas and U.S. Trade Policy, Institute for International Economics

(Washington, D.C., 1989).

18. We can only hope constitutional government will be restored soon in Haiti and Peru.

19. For an overview of the CAFTA's provisions, see Burcher, Paul: "U.S.-Canada Free Trade Energizes Bilateral Business," in *Business America*, April 8, 1991, U.S. Department of Commerce, Washington, D.C.

20. For a discussion of the North American Free Trade Area (NAFTA) negotiations, see "NAFTA: Generating Jobs for Americans," in *Business America*, U.S. Department of Commerce, Washington, D.C., April 8, 1991.

21. Direction of Trade Statistics Yearbook - 1991, International Monetary Fund, Washington, D.C. (1991), Tables 111, 156, and 998.

22. Ibid.

23. Reliable investment data are generally lacking, but some estimates place U.S. foreign investment in Latin America at more than 70 percent of all foreign investment there.

24. Direction of Trade Statistics Yearbook - 1991, International Monetary Fund, Washington, D.C. (1991), Tables 111 and 205.

25. Report of the National Bipartisan Commission on Central America, The White House, Washington, D.C. (1984).

26. CBI program concessions include duty-free entry for practically all Caribbean exports to the United States. Significant exceptions are textiles and apparel; leather footwear; canned tuna; sugar. The CBI program also contains incentives to promote U.S. investment and tourism in the area.

27. Among the sub-regional groups with concrete medium-term free trade commitments today are the Central American countries (including Panama); the Andean countries; MERCOSUR (a grouping comprising Brazil, Argentina, Uruguay, and Paraguay, and formed with the express purpose of establishing a regional common market); the Group of Three (Mexico, Colombia, and Venezuela). Chile and Mexico (the latter both separately as well as within the Group of Three) are pursuing free trade agreements with their neighbors, as well as with the United States. For an overview of the current state of play on these evolving sub-regional free trade groupings, see testimony of Deputy Assistant Secretary of State David Malpass before the Congressional Joint Economic Committee, Hearing on the Role of Trade in U.S.-Latin American Relations, Washington, D.C., April 2, 1992.

28. For a sampling of the responses of the hemisphere's leaders to the Bush Initiative, see the Organization of American State's "Report of the Ad Hoc Working Group to Study the Enterprise for the Americas Initiative," Washington, D.C., April 8, 1991.

29. Erzan, Refik and Alexander Yeats: "Free Trade Agreements with the United States -- What's in It For Latin America?" The World Bank, Working Papers, Washington, D.C., January 1992.

30. In her October 1991 (and soon to be published) paper entitled "CARICOM and the NAFTA," Bahamian central banker Delisle Worrell argues that CARICOM has little to gain, and that, for the Caribbean nation, an FTA with the United States would not be worthwhile unless clothing and sugar (two items now excluded from the CBI program) were included.

31. Erzan and Yeats, op. cit.

32. Hufbauer, op. cit., pp 143-147.

33. This is the case as well with arguments to the effect that the costs of even extreme trade protection, while not negligible, are rather modest. For arguments of this kind, see Krugman, Paul, The Age of Diminished Expectations: U.S. Economic policies in the 1990s, The Washington Post Company, Washington, D.C. (1990).

34. This writer observed these seminal changes directly while serving as Economic Counselor at the United States Embassy in Guatemala from 1988 to 1991.

35. Economic Report of the President, 1991, p. 240; The White House, Washington, D.C. (1991)

36. Ibid, p. 241. One of the ironies of the Japanese automobile VRA program is that, while U.S. auto makers captured only $2.6 billion of the $5.8 billion total (i.e., some 45 percent), the Japanese auto makers (and their workers) captured the remainder in the form of economic rents (i.e., higher prices for their auto exports than they would have otherwise received). This example points out clearly the drawbacks of using this type of trade intervention when other policies might be more appropriate.

37. For background on this subject see McCulloch, op. cit.

38. Hills, Carla. 1991. "Trade, the Americas, and the World." Address to the Organization of American States Conference of Trade Ministers, Washington, D.C., October 29, 1991. Office of the U.S. Trade Representative, Washington, D.C.

39. The CAFTA, for example, broke new ground on rules for international (bilateral) investment and intellectual property rights -- issues also on the table in the Uruguay Round. The

Uruguay Round, launched in 1986, is still in progress; by contrast, the CAFTA negotiations were concluded in less than two years.

40. These include, for example, the "acid rain" issue that has periodically vexed U.S.-Canadian relations, and ground water contamination by industrial pollutants, an irritant in U.S-Mexican relations.

41. The Central American countries, for example, have created the Committee on Central American Development, a regional agency whose purpose includes developing regional policies and programs for protecting Central America's ecosystems.

42. Howard, Richard. "U.S.-Mexico Cooperation Goes Far Beyond Trade," in *Business America*, U.S. Department of Commerce, Washington, D.C., April 8, 1991.

43. "Mexico Seeks Halt in U.S. Waste Plan," Washington Post, March 22, 1992, p. A-29.

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Gist: Enterprise for the Americas Initiative

Background

On June 27, 1990, President Bush announced the Enterprise for the Americas Initiative, a major initiative to help forge a genuine partnership of free market reform to promote economic growth and political stability in Latin America and the Caribbean. At that time, he noted that "prosperity in our hemisphere depends on trade, not aid," and that "the future of Latin America lies with free government and free markets."

Over the last decade, countries in Latin America and the Caribbean have confronted an economic crisis that also has affected the United States. As many of these countries have reduced imports, postponed investment, and struggled to service foreign debt, the United States has lost trade, markets, and investment opportunities.

A new generation of democratically elected leaders in the region has made progress in coping with this crisis. Their countries are beginning to move away from excessive government control and toward greater reliance on free market forces. The Enterprise for the Americas Initiative supports the efforts of these leaders, increasing the prospects for prosperity throughout the hemisphere.

The foreign ministers of the hemisphere endorsed the EAI at the meeting of the General Assembly of the Organization of American States in Santiago, Chile, June 3-8, 1991. They approved a resolution declaring it a positive new approach to trade, investment, and external debt.

The Initiative's Three Pillars

The initiative rests on three pillars through which the United States can support economic reform and sustained growth:

- Expanding trade by working with the countries of the region through the Uruguay Round of the General Agreement on Tariffs and Trade and by entering into free trade agreements with the ultimate goal of a hemisphere-wide free trade system;
- Promoting investment in the region and helping countries compete for capital by reforming policies that have discouraged private investment;
- Building on successful US efforts to ease debt burdens and to increase incentives for reform by offering additional debt measures. As part of this approach, the United States would support natural resources management as a key element of protecting the environment and building a strong future for the hemisphere.

Key Components Of Trade Vision

- Progress in the General Agreement on Tariffs and Trade and the North American Free Trade Agreement negotiations.
- Cooperation on trade liberalization issues through trade and investment councils.
- Active liberalization of trade and investment policies in Latin America and the Caribbean.
- As markets in Latin America and the Caribbean grow and liberalize, gradual incorporation into a growing hemispheric system of free trade. ❑

Trade

The Enterprise for the Americas Initiative envisions a hemisphere-wide free trade system. To achieve this long- range goal, the United States works to develop more productive partnerships with its neighbors in the hemisphere.

First, it remains committed to the multilateral trading system and to the success of the Uruguay Round. The EAI and the Uruguay Round complement each other; a successful round could facilitate trade negotiations in the hemisphere.

Second, the United States, Canada, and Mexico are conducting free trade negotiations, made possible by congressional action on May 23-24, 1991, granting the executive branch "fast track authority" to negotiate trade agreements.

Third, the United States has negotiated framework agreements on trade and investment with those countries and groups of countries that wish to work toward freer trade in the hemisphere. Sixteen trade and investment framework agreements have been signed, covering 31 countries in the hemisphere.

Legislative Proposal

On September 14, 1990, President Bush sent to Congress a legislative proposal to implement the investment, debt, and environmental elements of the initiative. Congress approved some elements in October 1990, with passage of the EAI portion of the Agricultural Trade Development and Assistance Act, which authorized reduction of PL 480 (food aid) concessional debt.

Investment. On February 11, 1992, at the White House, President Bush hosted the signing of the agreement creating the multilateral investment fund for Latin America and the Caribbean part of the EAI. The fund will be administered by the Inter-American Development Bank (IDB) and will be capitalized by donors over a 5-year period with a funding target of $1.5 billion. The President is seeking authorization for a US Government contribution of $100 million annually for 5 years. Japan, Canada, and several European and at least 13 Latin American countries have also pledged to participate.

Disbursement from the fund would encourage market-oriented investment policy initiatives and reforms and finance technical assistance for privatization efforts, business infrastructure, and worker training and education programs.

The fund would complement country reforms undertaken as part of a new IDB lending program for nations that take significant steps to remove barriers to investment.

Debt and Environment. The legislation establishes a facility to administer debt reduction for countries meeting investment reform and other policy conditions. Latin American and Caribbean countries can qualify if they, as appropriate, have:

- An International Monetary Fund program or the equivalent;
- World Bank structural or sectoral adjustment loans;
- Undertaken major investment reforms in conjunction with an IDB loan or are implementing more liberal investment rules;
- Negotiated satisfactory financing programs with commercial banks.

The Secretary of the Treasury leads a US Government inter-agency process that determines country eligibility based on these criteria. This group makes decisions on the extent of debt reduction on eligible concessional obligations of qualifying countries, currently limited to PL 480 debt. If authorized by Congress, it also would determine reductions of other concessional debt (USAID), as well as Export-Import Bank and Commodity Credit Corporation obligations. These would be made to facilitate debt-for-equity, debt-for-nature, or debt-for-development swaps. During 1991, agreements under the EAI were signed with Chile, Bolivia, and Jamaica, reducing their concessional debt to the United States substantially.

The United States will seek an environmental agreement with each eligible country that will allow it to make interest payments in local currency on new obligations resulting from debt reduction. To date, environmental agreements have been signed with Bolivia and Jamaica. One with Chile is imminent. These interest payments will be deposited in an Environmental Fund to support environmental projects. The Fund would be managed by an environmental commission made up of members from the US Government, the debtor government, and non-governmental groups from that country. ■

President Bush

Current Policy No. 1288

Enterprise for the Americas Initiative

United States Department of State
Bureau of Public Affairs
Washington, DC

Following are remarks by President Bush before administration officials and members of the business community, Washington, DC, June 27, 1990.

Thank you all very much for coming to the White House. It is my pleasure to welcome so many distinguished guests with such strong interests in the vital Latin American and Caribbean region.

In the past 12 months everyone of us, from the men in the White House to the man on the street has been fascinated by the tremendous changes, the positive changes taking place around the world. Freedom has made great gains, not just in Eastern Europe, but right here in the Americas. We've seen a resurgence of democratic rule, a rising tide of democracy never before witnessed in the history of this beloved hemisphere. And with one exception, Cuba, the transition to democracy is moving toward completion. We can all sense the excitement that the day is not far off when Cuba joins the ranks of world democracies and makes the Americas fully free.

With one exception, that's the case. But the political transformation sweeping the rest of Latin America and the Caribbean has its parallel in the economic sphere. Throughout the region, nations are turning away from the statist economic policies that stifle growth and are now looking to the power of the free market to help this hemisphere realize its untapped potential for progress. A new leadership has emerged backed by the strength of the peoples' mandate—leadership that understands that the future of Latin America lies with free government and free markets. In the words of Colombia's courageous leader, Virgilio Barco—President Barco: "The long-running match between Karl Marx and Adam Smith is finally coming to an end" with the "recognition that open economies with access to markets can lead to social progress."

For the United States, these are welcome developments—developments that we're eager to support. But we recognize that each nation in the region must make its own choices. There is no blueprint, no one size fits all approaches to reform. The primary responsibility for achieving economic growth lies with each individual country. Our challenge in this country is to respond in ways that support the positive changes now taking place in the hemisphere. We must forge a genuine partnership for free market reform.

Back in February, I met in Cartagena [Colombia] with heads of the three Andean nations. And I came away from that meeting convinced that the United States must review its approach not only to that region but to Latin America and the Caribbean as a whole. I asked Treasury Secretary Brady to lead a review of US economic policy toward this vital region, to make a fresh assessment of the problems and opportunities we'll encounter in the decade ahead. That review is now complete, and the results are in. And the need for new economic initiatives is clear and compelling.

All signs point to the fact that we must shift the focus of our economic interaction toward a new economic partnership because prosperity in our hemisphere depends on trade, not aid. I've asked you here today to share with you some of the ideas, some of the ways we can build a broad-based partnership for the 1990s—to announce the new Enterprise for the Americas Initiative that creates incentives to reinforce Latin America's growing recognition that free market reform is the key to sustained growth and political stability.

The three pillars of our new initiative are trade, investment, and debt. To expand trade, I propose that we begin the process of creating a hemisphere-wide free trade zone; to increase investment that we adopt measures to create a new flow of capital into the region; and to further ease the debt—the burden of debt—a new approach to debt in the region with important benefits for our environment.

Trade

[In] the 1980s, trade within our hemisphere [tr]ailed the overall pace of growth in world trade. One principal reason for that: over-restrictive trade barriers that wall off the economies of our region from each other, and from the United States, at great cost to us all. *These barriers are the legacy of the misguided notion that a nation's economy needs protection in order to thrive.* The great economic lesson of this century is that protectionism still stifles progress, and free markets breed prosperity. To this end, we've formulated a three-point trade plan to encourage the emerging trend toward free market reform and that is now gathering forces in the Americas.

First, as we enter the final months of the current Uruguay Round of the world trade talks, I pledge close cooperation with the nations of this hemisphere. The successful completion of the Uruguay Round remains the most effective way of promoting long-term trade growth in Latin America and the increased integration of Latin nations into the overall global trading system. Our aim in the Uruguay Round is free and fair trade.

Through these talks, we are seeking to strengthen existing trade rules and to expand them to areas that do not now have agreed rules of fair play. To show our commitment to our neighbors in Latin America and the Caribbean, we will seek deeper tariff reductions in this round on products of special interest to them.

Second, we must build on the trend we see toward free markets and make our ultimate aim a free trade system that links all of the Americas—North, Central, and South. We look forward to the day when not only are the Americas the first fully free, democratic hemisphere, but when all are equal partners in a free trade zone stretching from the port of Anchorage to the Tierra del Fuego.

I'm announcing today that the United States stands ready to enter into free trade agreements with other markets in Latin America and the Caribbean, particularly with groups of countries that have associated for purposes of trade liberalization. The first step in this process is the now-announced free trade agreement with Mexico.[1] We must all recognize that we won't bring down barriers to free trade overnight; changes so far-reaching may take years of preparation and tough negotiations. But the payoff in terms of prosperity is worth every effort. And now is the time to make a comprehensive free trade zone for the Americas our long-term goal.

And **third**, I understand that some countries aren't yet ready to take that dramatic step to a full free trade agreement. And that's why we're prepared to negotiate with any interested nation in the region bilateral framework agreements to open markets and develop closer trade ties. Such agreements already exist with Mexico and Bolivia. Framework agreements will enable us to move forward on a step-by-step basis to eliminate counterproductive barriers to trade and toward our ultimate goal of free trade. And that's a prescription for greater growth and a higher standard of living in Latin America and, right here at home, a new market for American products and more jobs for American workers.

A new leadership has emerged, backed by the strength of the peoples' mandate—leadership that understands that the future of Latin America lies with free government and free markets.

Promoting free trade is just one of three key elements in our new Enterprise for the Americas Initiative. And our second pillar is increased investment.

Investment Reform

The competition for capital today is fierce. And the key to increased investment is to be competitive, to turn around the conditions that have discouraged both foreign and domestic investment, reduce the regulatory burden, clear away the thicket of bureaucratic barriers that choke off Latin America's aspiring entrepreneurs.

In one large Latin city, for instance, it takes almost 300 days to cut through the red tape to open a small garment shop. In another country, the average overseas caller has to make five phone calls to get through, and the wait for a new telephone line can be as long as 5 years—and that's got to change.

Investment reform is essential to make it easier to start new business ventures and make it possible for international investors to participate and profit in Latin American markets. In order to create incentives for investment reform, the United States is prepared to take the following steps:

First, the United States will work with the Inter-American Development Bank (IDB) to create a new lending program for nations that take significant steps to remove impediments to international investment. The World Bank could also contribute to this effort; and

Second, we propose the creation of a new investment fund for the Americas. This fund, administered by the IDB, could provide up to $300 million a year in grants in response to market-oriented investment reforms in progress in privatization.

The United States intends to contribute $100 million to the fund, and we will seek matching contributions from Europe and Japan. But in order to create an attractive climate for new investment, we must build on our successful efforts to ease the debt burden. That's the third pillar of this new Enterprise for the Americas initiative.

Easing the Debt Burden

Many nations have already undertaken painful economic reforms for the sake of future growth. But the investment climate remains clouded, weighted down by the heavy debt burden. Under the Brady plan, we are making significant progress. The agreements reached with Mexico and Costa Rica and Venezuela are already having a positive impact on investment in those countries.

Mexico, to take just one example, has already seen a reversal of the destructive capital flight that drained so many Latin American nations of precious investment resources. That's critical. If we restore confidence, capital will follow.

As one means of expanding our debt strategy we propose that the IDB add its efforts and resources to those of the International Monetary Fund (IMF) and the World Bank to support commercial bank debt reduction in Latin America and the Caribbean and, as in the case of World Bank and IMF, IDB funds should be directly linked to economic reform.

While the Brady plan has helped nations reduce commercial bank debt for nations with high levels of official debt—debt owed to governments rather than

[1]On June 11, 1990, Presidents Bush and Salinas endorsed the goal of a comprehensive free trade agreement between the United States and Mexico. The presidents have directed their trade ministers to undertake the consultations and preparatory work needed to initiate such negotiations and to report back to them before the two presidents' next meeting in December 1990.

rivate financial institution—the burden emains heavy. And today, across Latin America, official debt owed to the US Government amounts to nearly $12 billion, with $7 billion of that amount in concessional loans. In many cases, the heaviest official debt burdens fall on some of the region's smallest nations—countries like Honduras and El Salvador and Jamaica.

That's a problem we must address today. As the key component in addressing the region's debt problem, I am proposing a major new initiative to reduce Latin America's and the Caribbean's official debt to the United States for countries that adopt strong economic and investment reform programs with the support of international institutions.

Our debt reduction program will deal separately with concessional and commercial types of loans. On the concessional debt, loans made from aid or food for peace accounts, we will propose substantial debt reductions for the most heavily burdened countries. And we will also sell a portion of outstanding commercial loans to facilitate these debt-for-equity and debt-for-nature swaps in countries that have set up such programs.

Strengthening Environmental Policies

These actions will be taken on a case-by-case basis. One measure of prosperity in the most important long-term investment any nation can make is environmental well-being. As part of our Enterprise for the Americas Initiative, we will take action to strengthen environmental policies in this hemisphere.

Debt-for-nature swaps are one example—patterned after the innovative agreements reached by some Latin American nations and their commercial creditors. We will also call for the creation of environmental trusts, where interest payments owed on restructured US debt will be paid in local currency and set aside to fund environmental projects in the debtor countries.

These innovative agreements offer a powerful new tool for preserving the natural wonders of this hemisphere that we share. From the vistas of the unspoiled Arctic, to the beauties of the barrier reef off Belize, to the rich rain forests of the Amazons, we must protect this living legacy that we hold in trust. For an increasing number of our neighbors, the need for free market reform is clear. These nations need economic breathing room to enact bold reforms. And this official debt initiative is one answer. A way out from under the crushing burden of debt that slows the process of reform.

Conclusion

I know there is some concern that the revolutionary changes we've witnessed this past year in Eastern Europe will shift our attention away from Latin America. But I want to assure all of you here today, as I've assured many democratic leaders in Central and South America and the Caribbean, and Mexico, the United States will not lose sight of the tremendous challenges and opportunities right here in our own hemisphere. And indeed, as we talk with the leaders of the G-24 about the emerging democracies in Europe—I've been talking to them also about their supporting democracy and economic freedom in Central America. Our aim is a closer partnership between the Americas and our friends in Europe and in Asia.

Two years from now, our hemisphere will celebrate the 500th anniversary of an epic event, Columbus' discovery of America, our New World. And we trace our origins, our shared history to the time of Columbus' voyage and the courageous quest for the advancement of man. Today, the bonds of our common heritage are strengthened by the love of freedom and a common commitment to democracy. Our challenge, the challenge in this new era of the Americas is to secure this shared dream and all its fruits for all the people of the Americas—North, Central, and South.

The comprehensive plan that I've just outlined is proof positive the United States is serious about forging a new partnership with our Latin American and Caribbean neighbors. We're ready to play a constructive role at this critical time to make ours the first fully free hemisphere in all of history. ■

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